

STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

*Material for
Staff Presentation to the
Federal Open Market Committee*

July 8, 1986

Principal Assumptions

Monetary Policy

- Growth of M2 and M3 around the middle of their ranges in 1986 and similar expansion in 1987.

Fiscal Policy

- Deficit-reducing actions of about \$45 billion in fiscal year 1987.

Other

- Major features of Senate tax reform bill are implemented.
- Foreign exchange value of the dollar about 10 percent lower by year-end 1987.
- Oil prices settle around \$16 per barrel.

Federal Budget

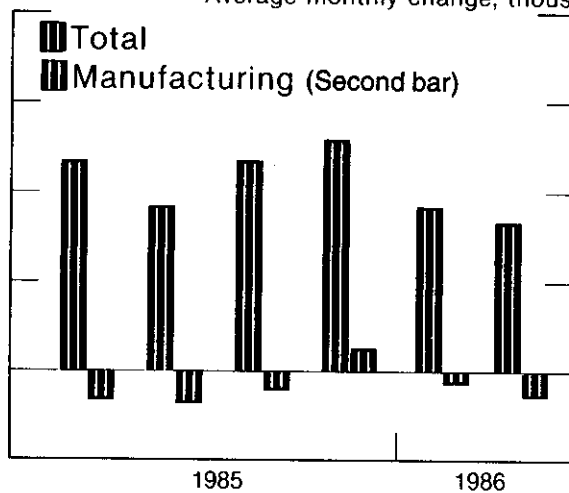
	Actual FY 1985	Staff FY 1986	Staff FY 1987	Cong. Resolution FY 1987
Outlays	946	984	1003	995
Receipts	734	768	833	852
Deficit	212	215	170	143
High Employment Deficit	153	168	135	NA

Key Tax-Reform Features

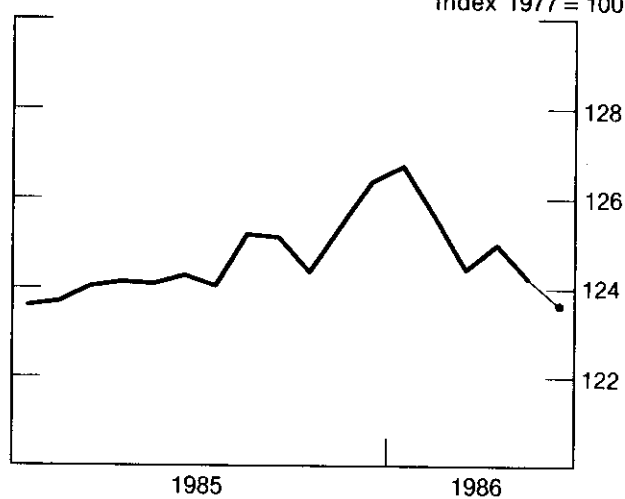
- Phased-in Reduction of Personal Income Taxes
- Overall Increase in Business Taxes
 - Removal of Investment Tax Credit
 - Less Attractive Depreciation Allowances
 - Restrictions on Tax Shelters
 - Corporate Tax Rates Lowered

Employment*

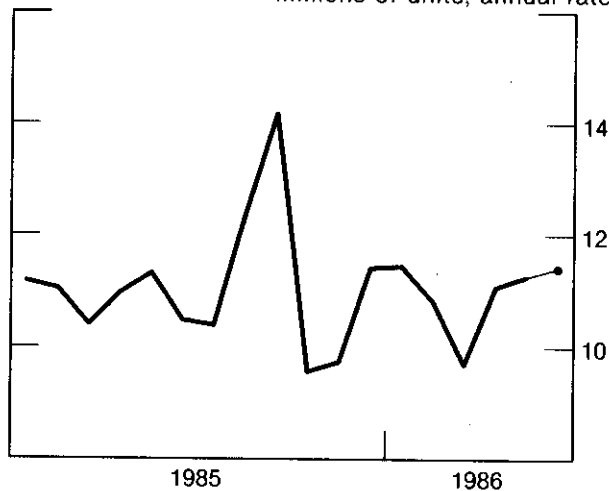
Average monthly change, thousands

**Industrial Production**

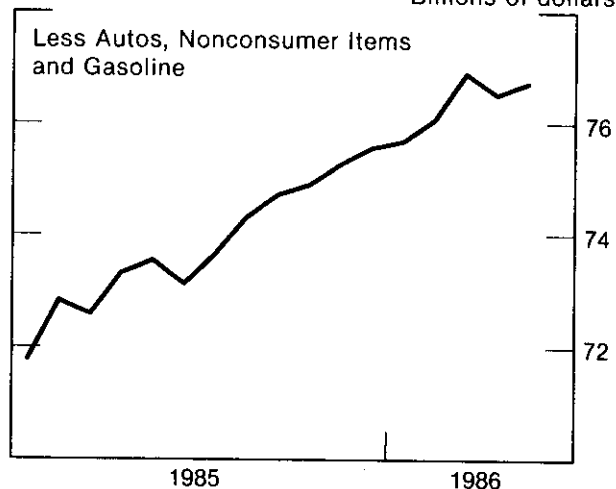
Index 1977 = 100

**Auto Sales**

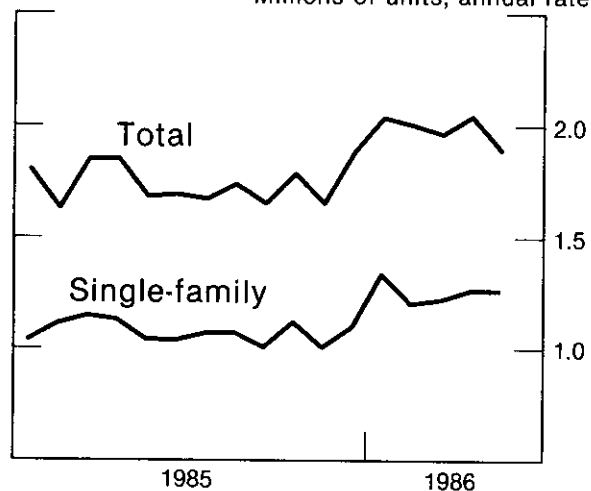
Millions of units, annual rate

**Retail Sales**

Billions of dollars

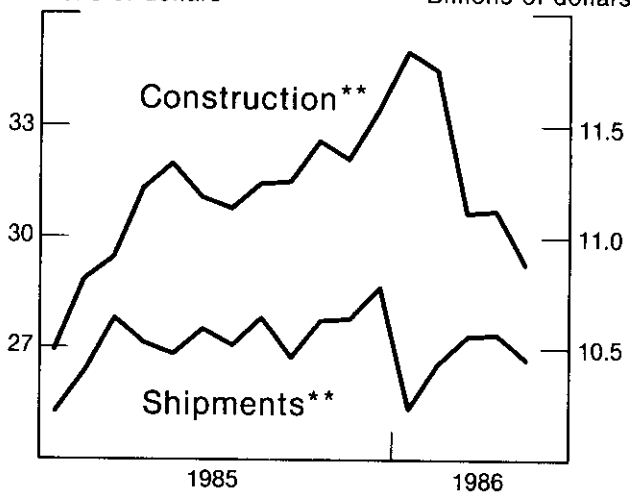
**Housing Starts**

Millions of units, annual rate

**Business Investment**

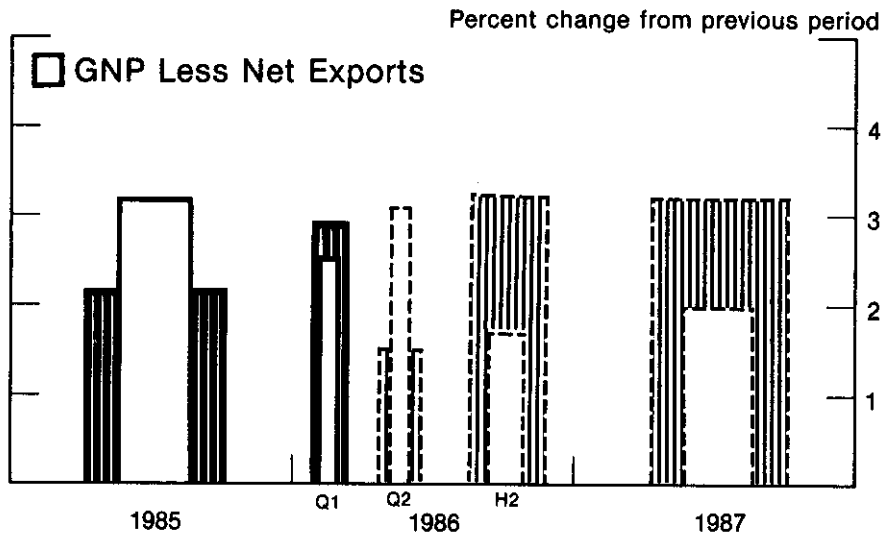
Billions of dollars

Billions of dollars

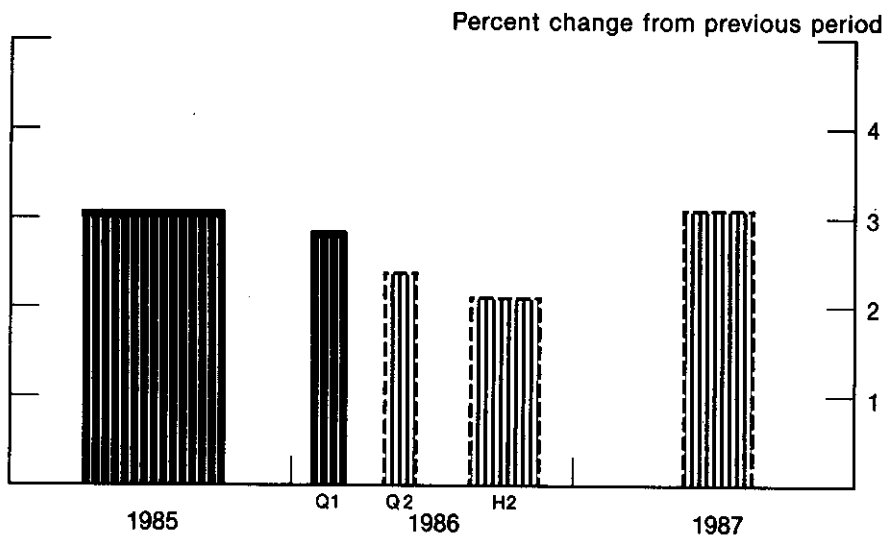


*Adjusted for strikes.

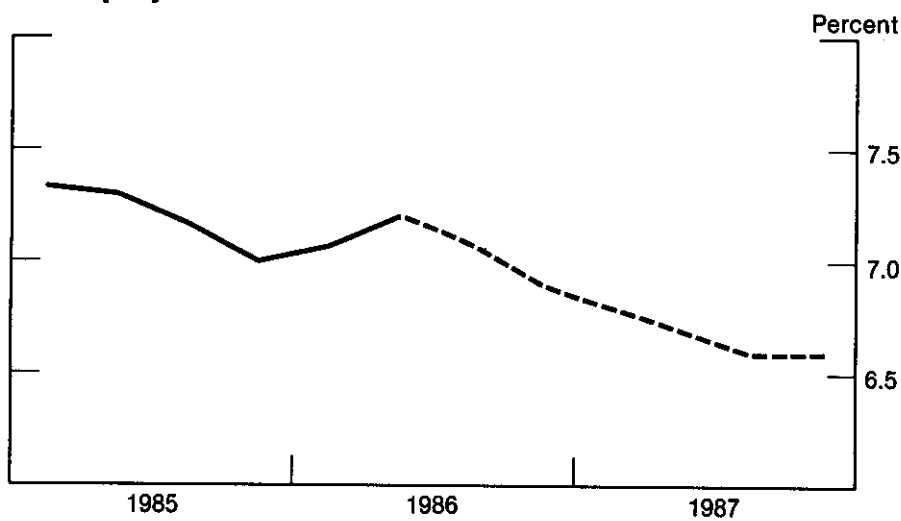
**Nonresidential construction put in place.
**Shipments of nondefense capital goods.

Real GNP

	Real GNP	Less Net Exports
1985	2.1	3.2
1986	2.7	2.3
1987	3.2	2.0

GNP Deflator

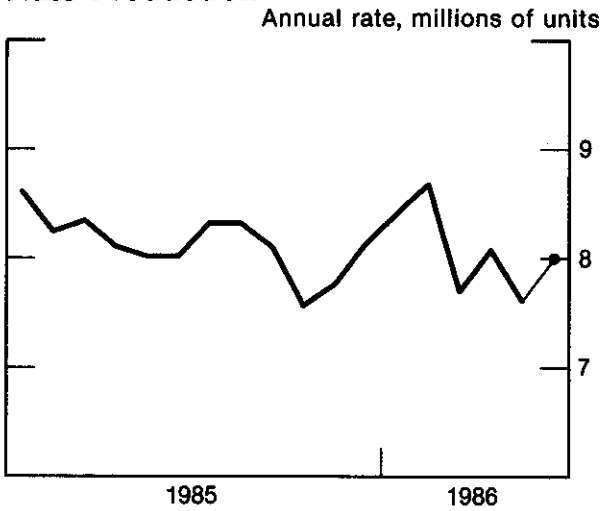
	GNP Deflator
1985	3.1
1986	2.4
1987	3.1

Unemployment Rate

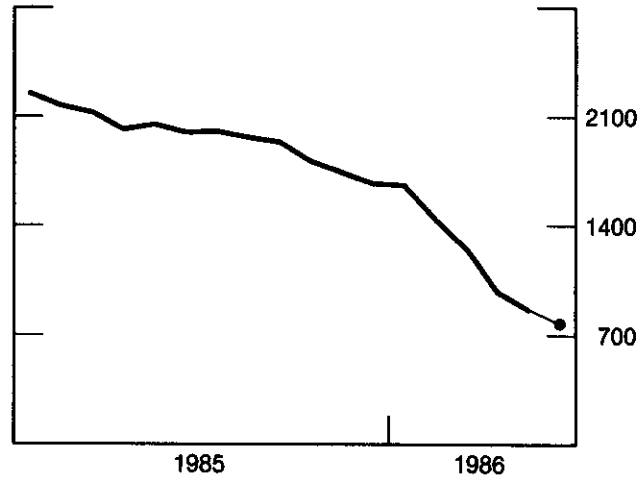
	Q4 Level
1985	7.0
1986	6.9
1987	6.6

Chart 5

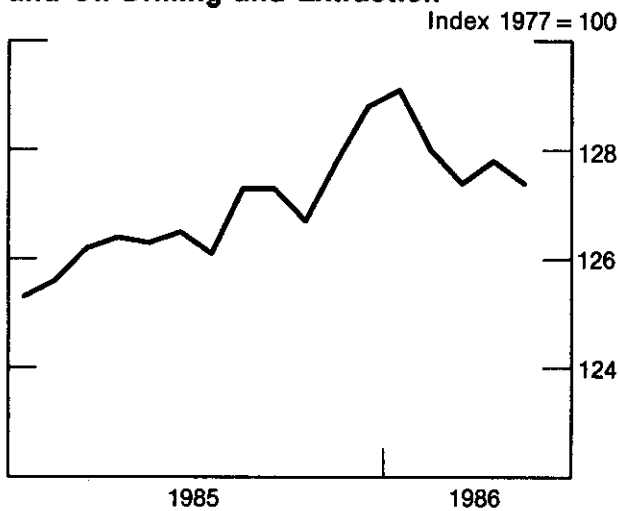
Auto Production



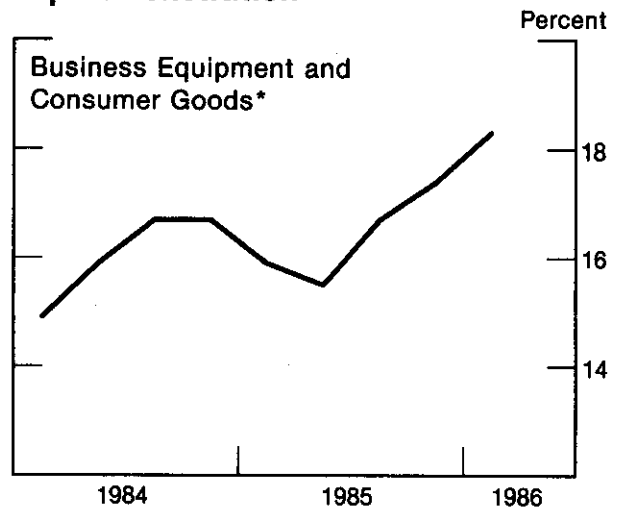
Rotary Rigs in Use



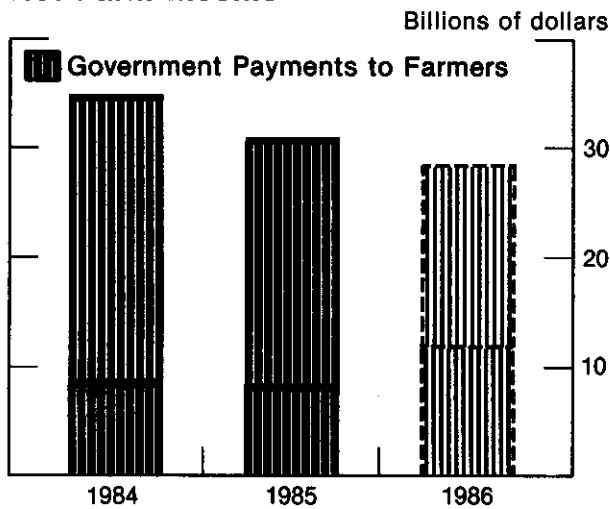
Industrial Production Less Motor Vehicles and Oil Drilling and Extraction



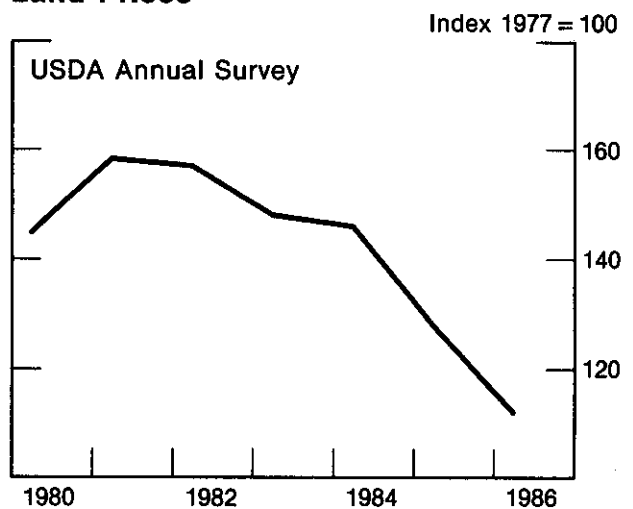
Import Penetration



Net Farm Income

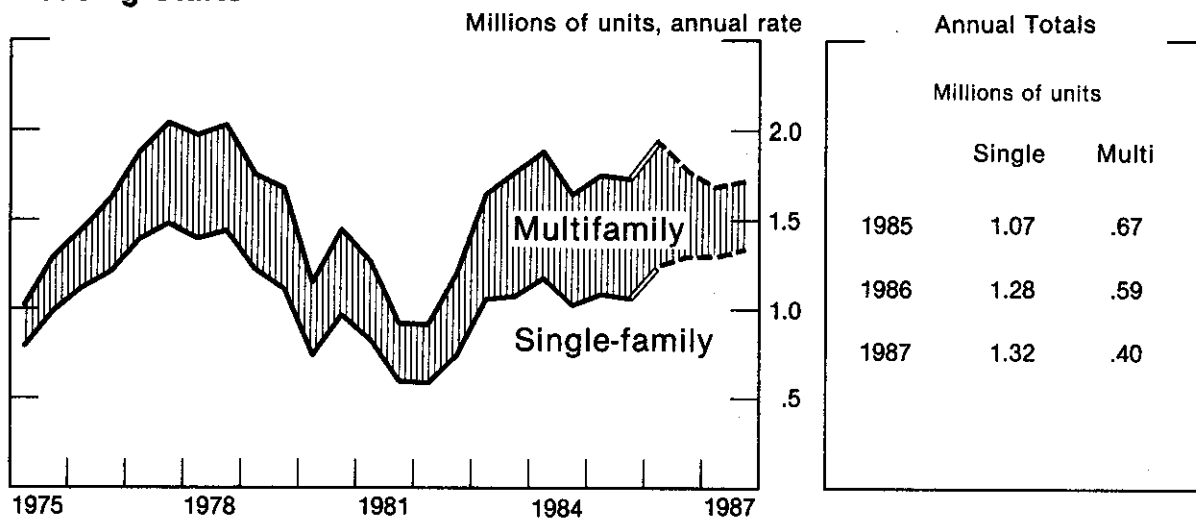


Land Prices

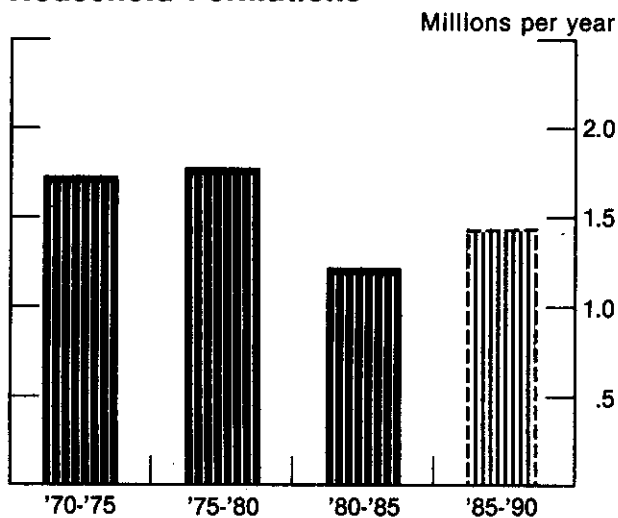


*Imports of capital and consumer goods, excluding motor vehicles and food, relative to corresponding components of PDE and PCE.

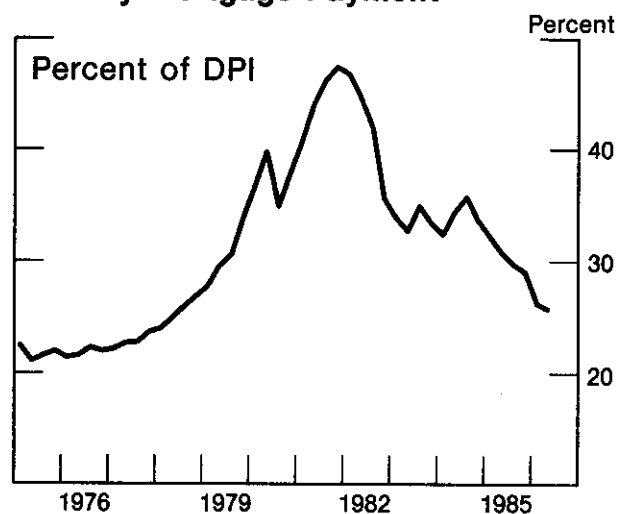
Housing Starts



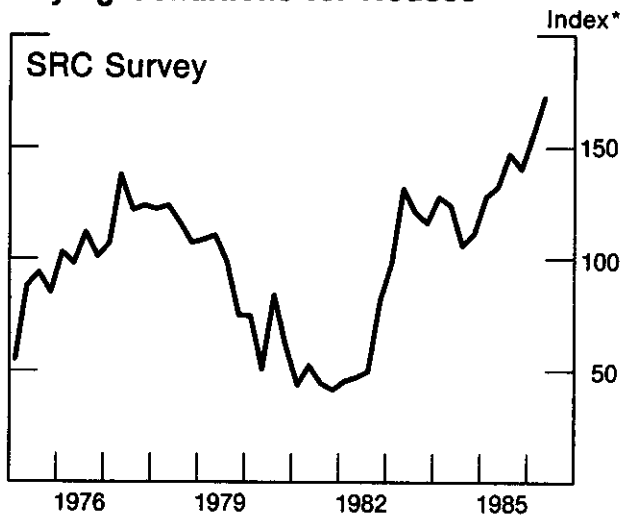
Household Formations



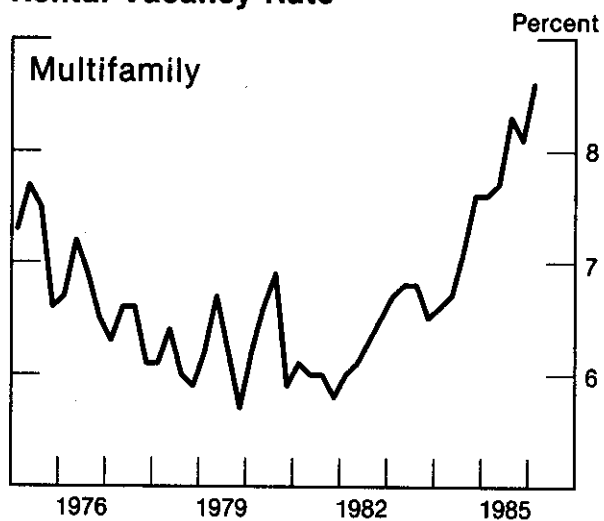
Monthly Mortgage Payment



Buying Conditions for Houses

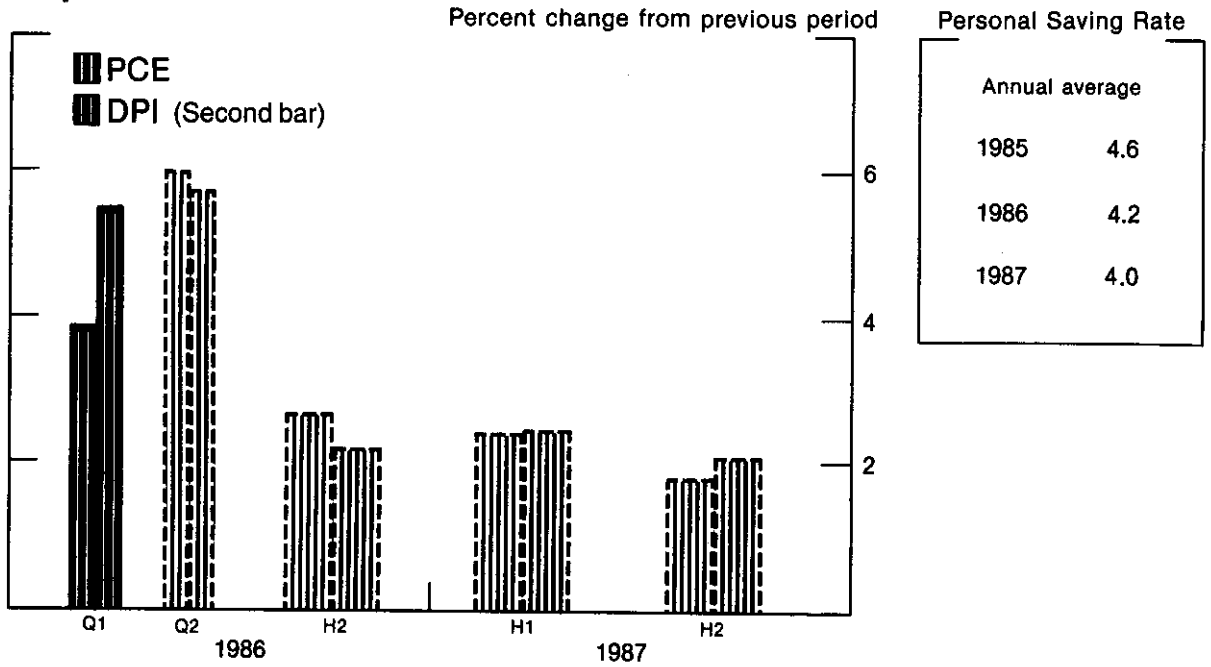


Rental Vacancy Rate

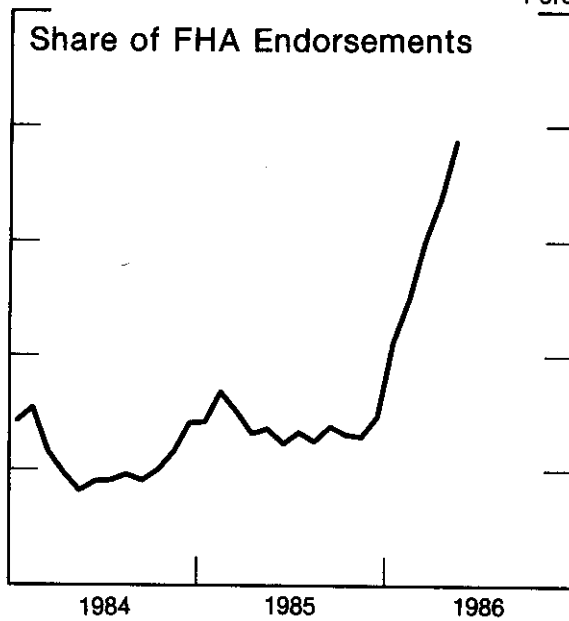


*Good time to buy minus bad time plus 100.

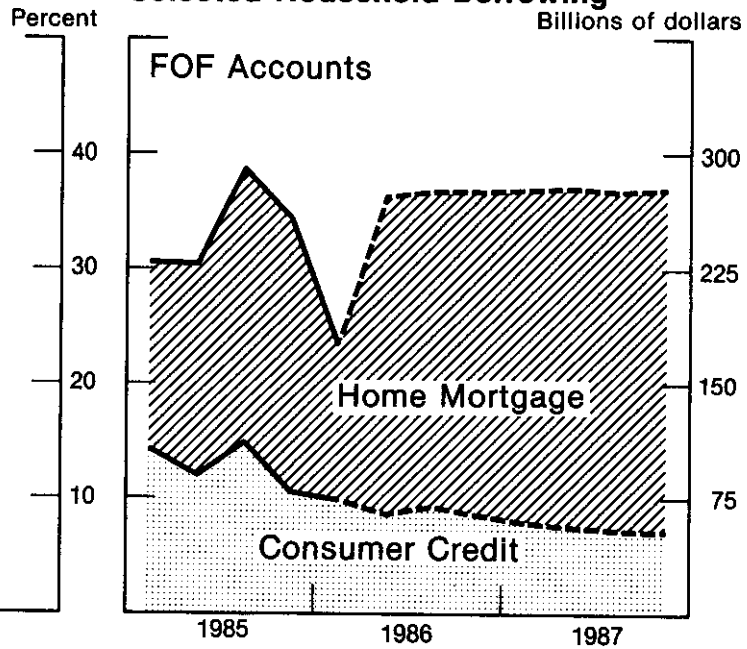
Real Personal Consumption Expenditures and Disposable Personal Income



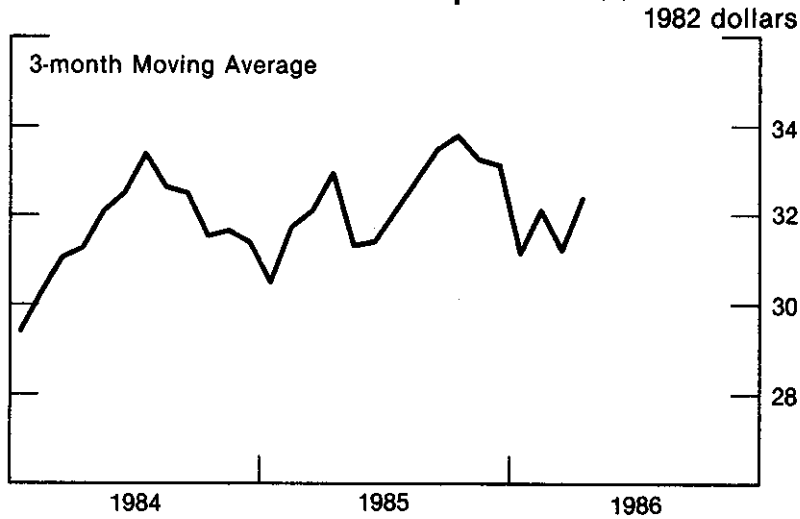
Mortgage Refinancings



Selected Household Borrowing



Contracts and Orders for Capital Goods

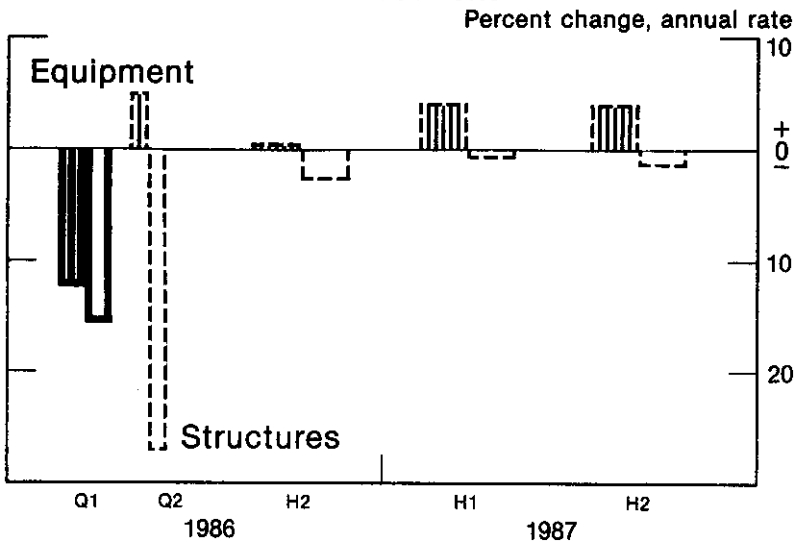


Commerce Department P&E Survey for 1986

Percent change from 1985

	Winter	Spring
Total	2.3	.2
Total less Petroleum and Mining	3.7	3.2

Real Business Fixed Investment

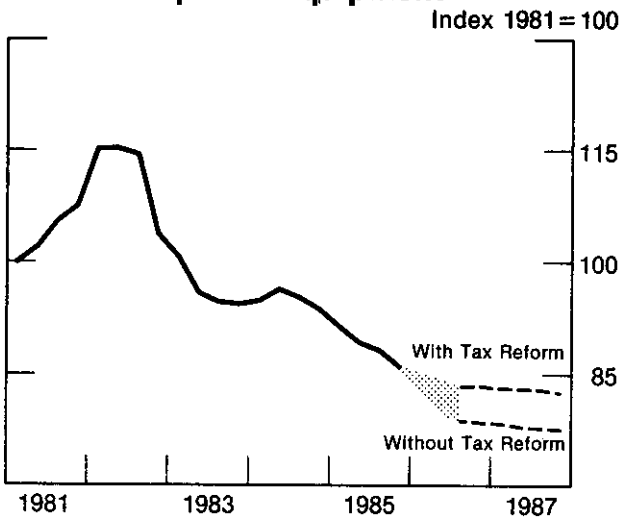


Total BFI

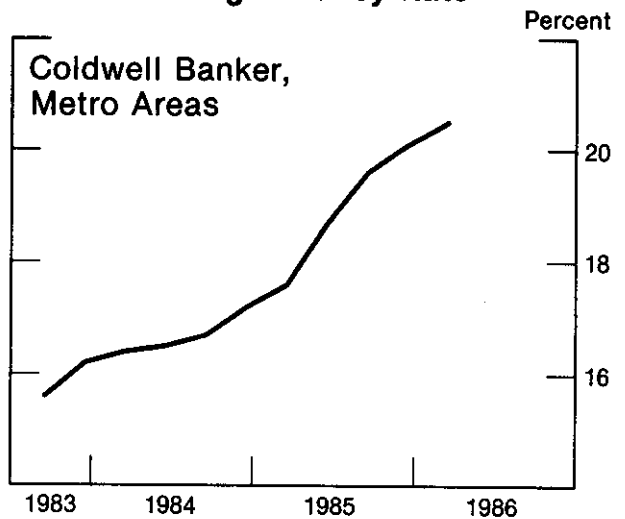
Percent change, annual rate

1986 Q1	-13.3
Q2	-7.1
H2	-0.4
1987 H1	2.5
H2	2.4

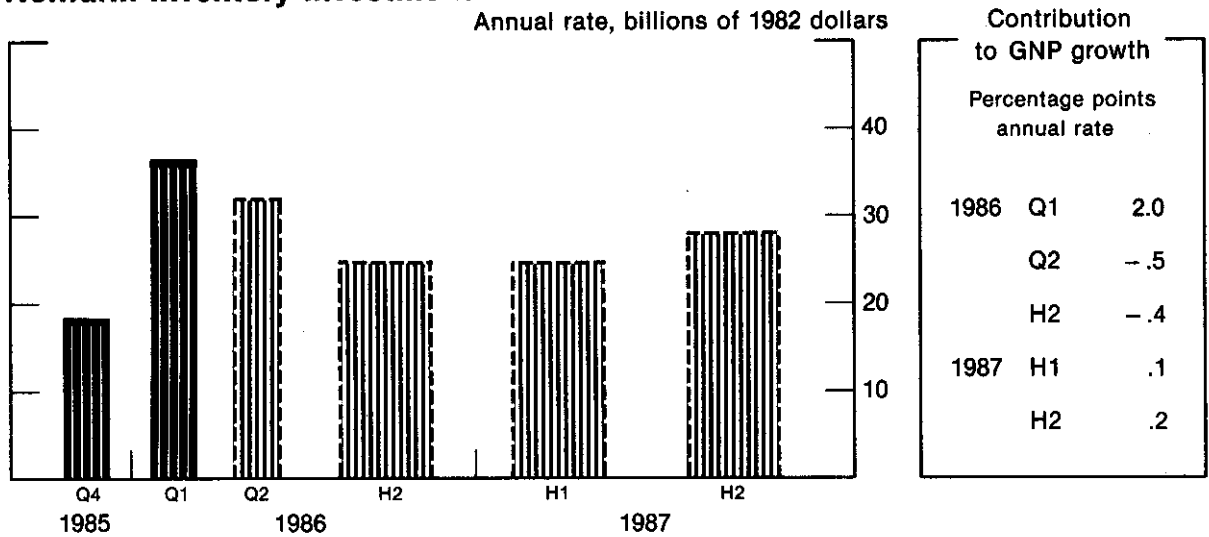
Cost of Capital—Equipment



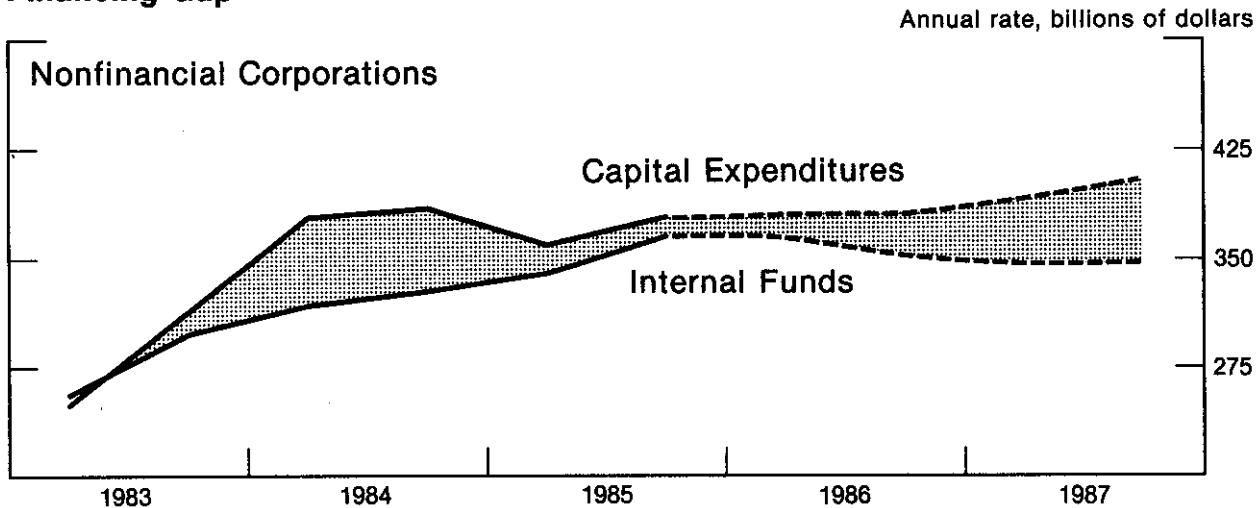
Office Building Vacancy Rate



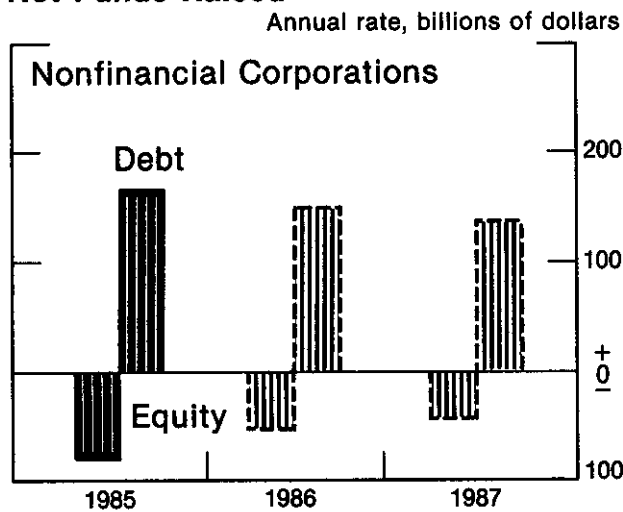
Nonfarm Inventory Investment



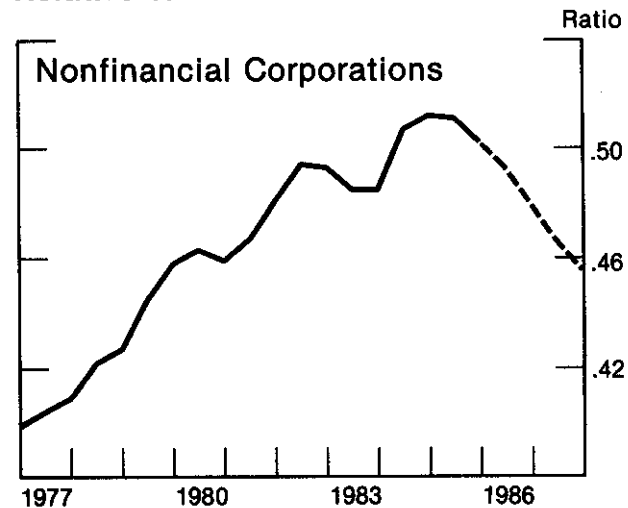
Financing Gap



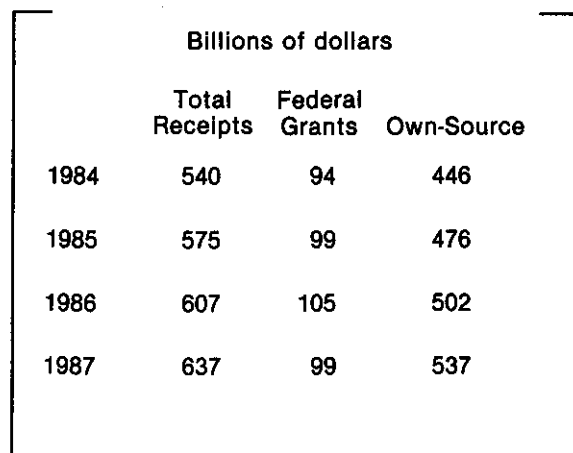
Net Funds Raised



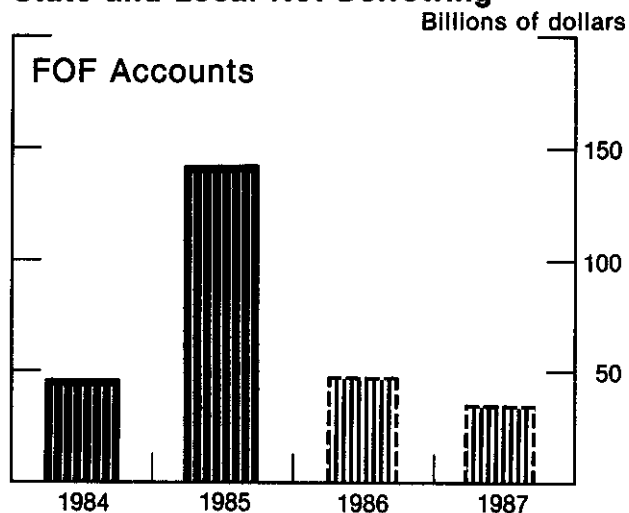
Loans and Short-term Paper Relative to Total Debt



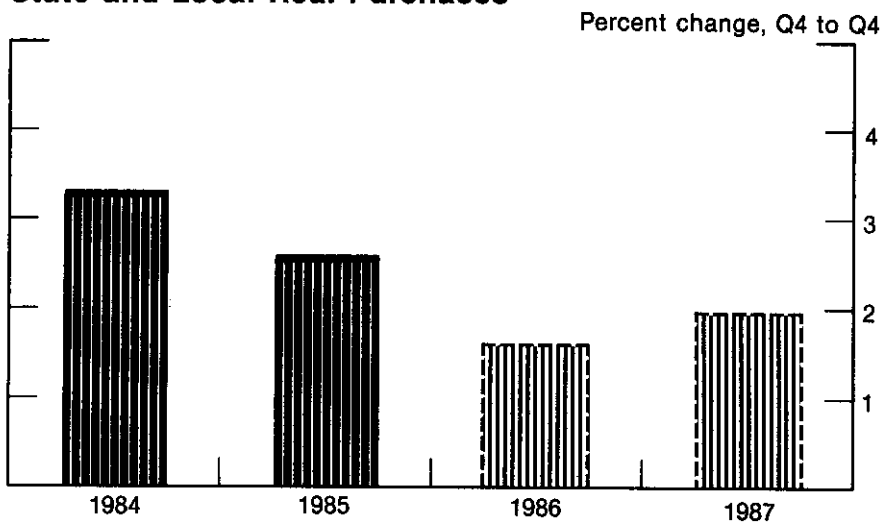
State and Local Government Receipts



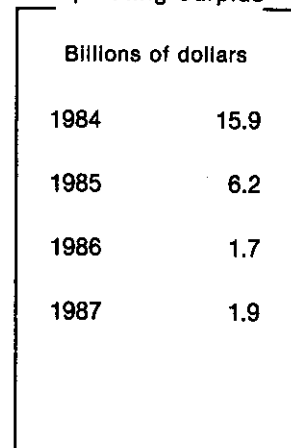
State and Local Net Borrowing



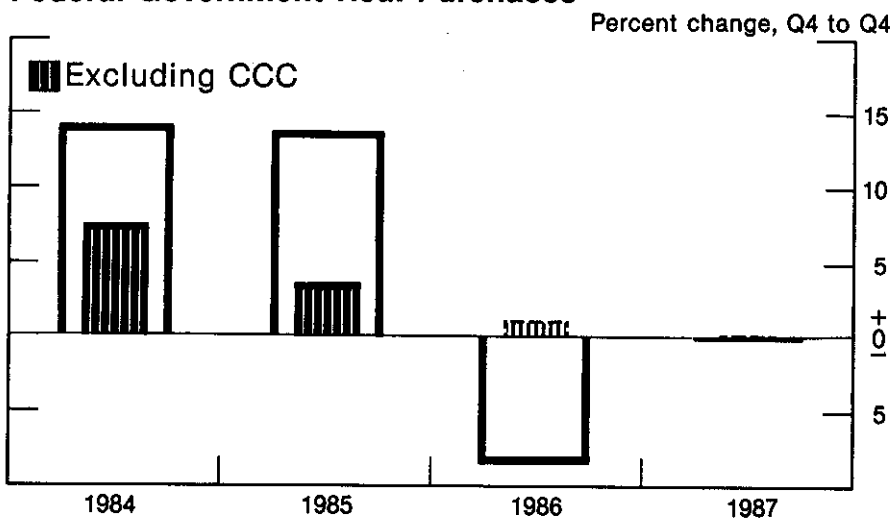
State and Local Real Purchases



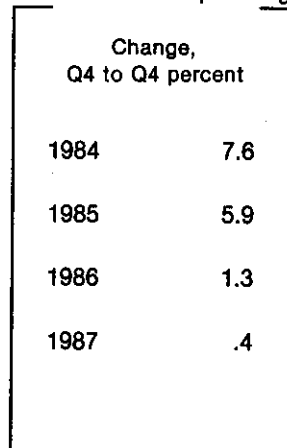
Operating Surplus



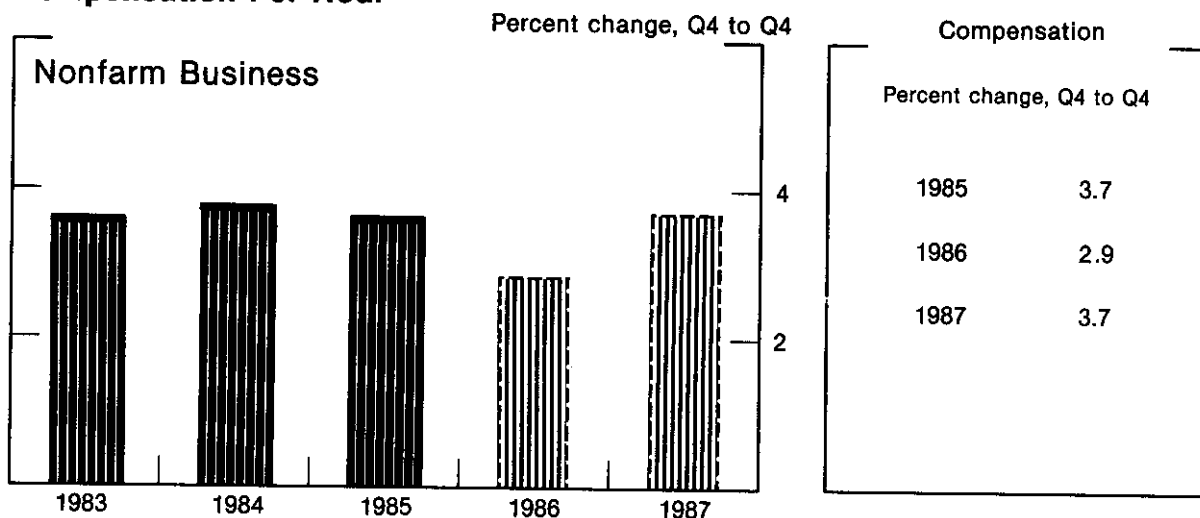
Federal Government Real Purchases



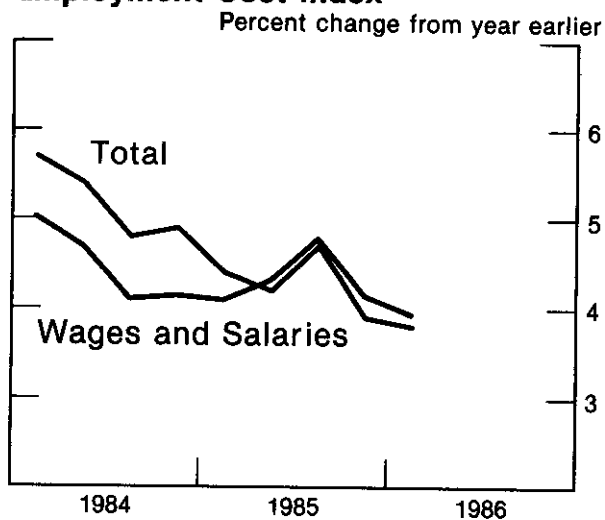
Real Defense Spending



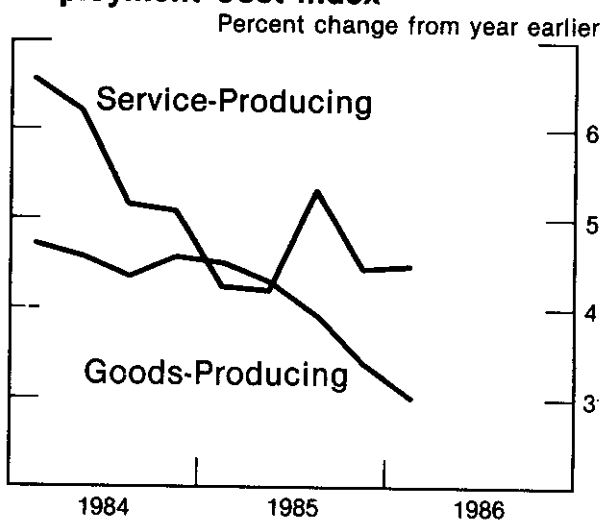
Compensation Per Hour



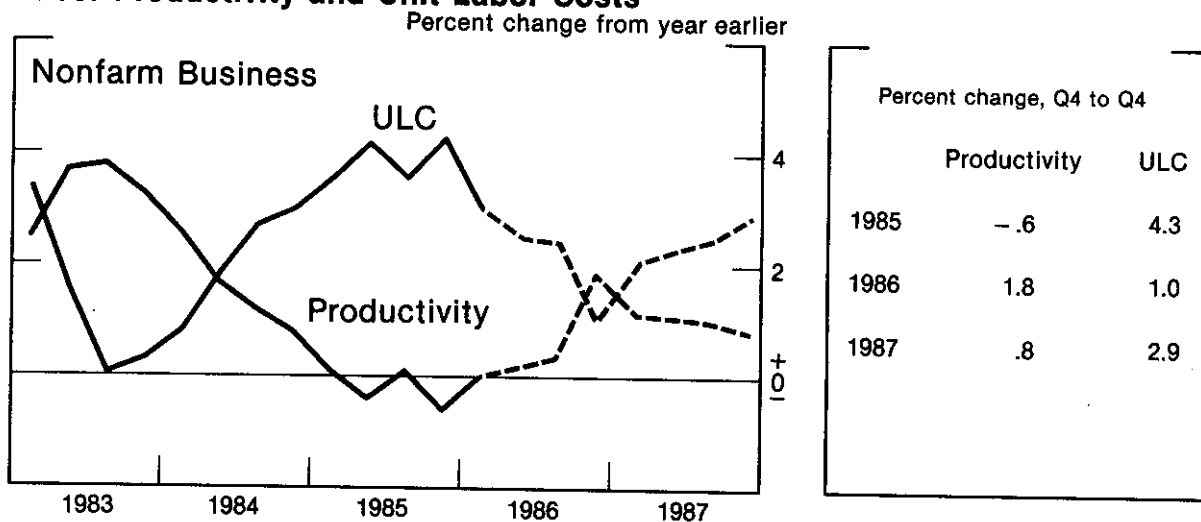
Employment Cost Index

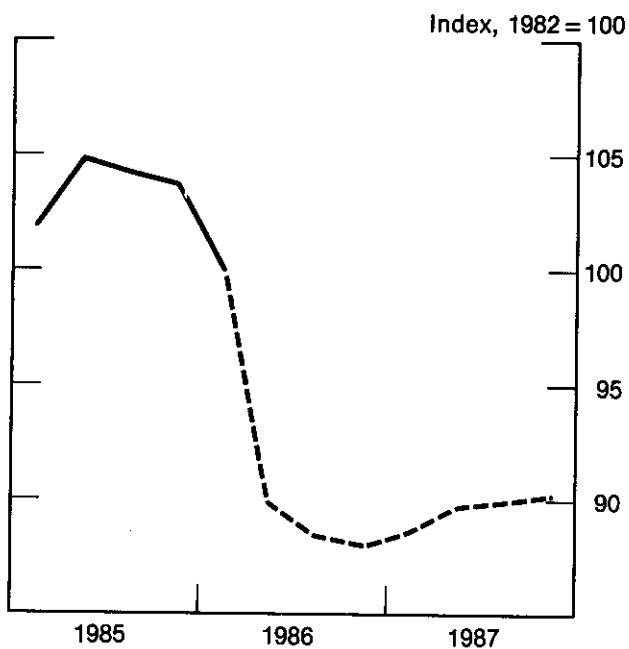
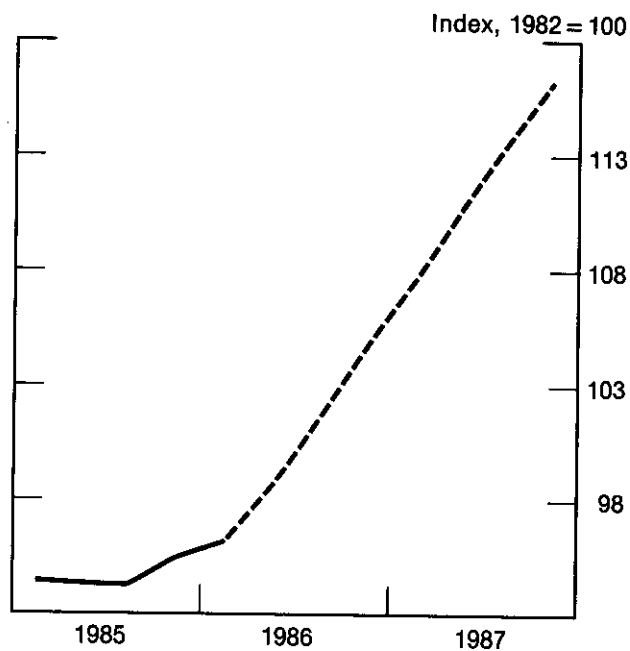
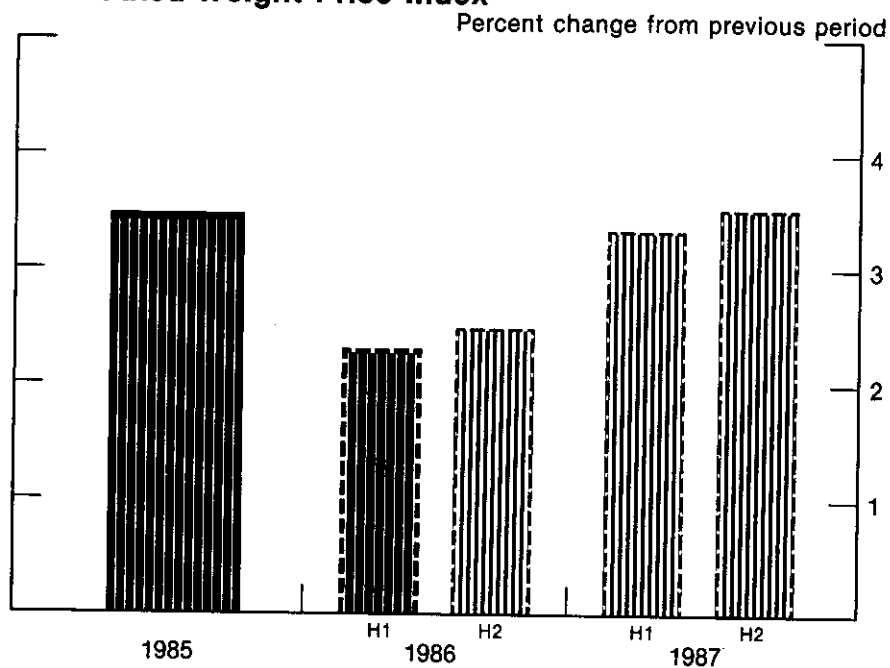


Employment Cost Index



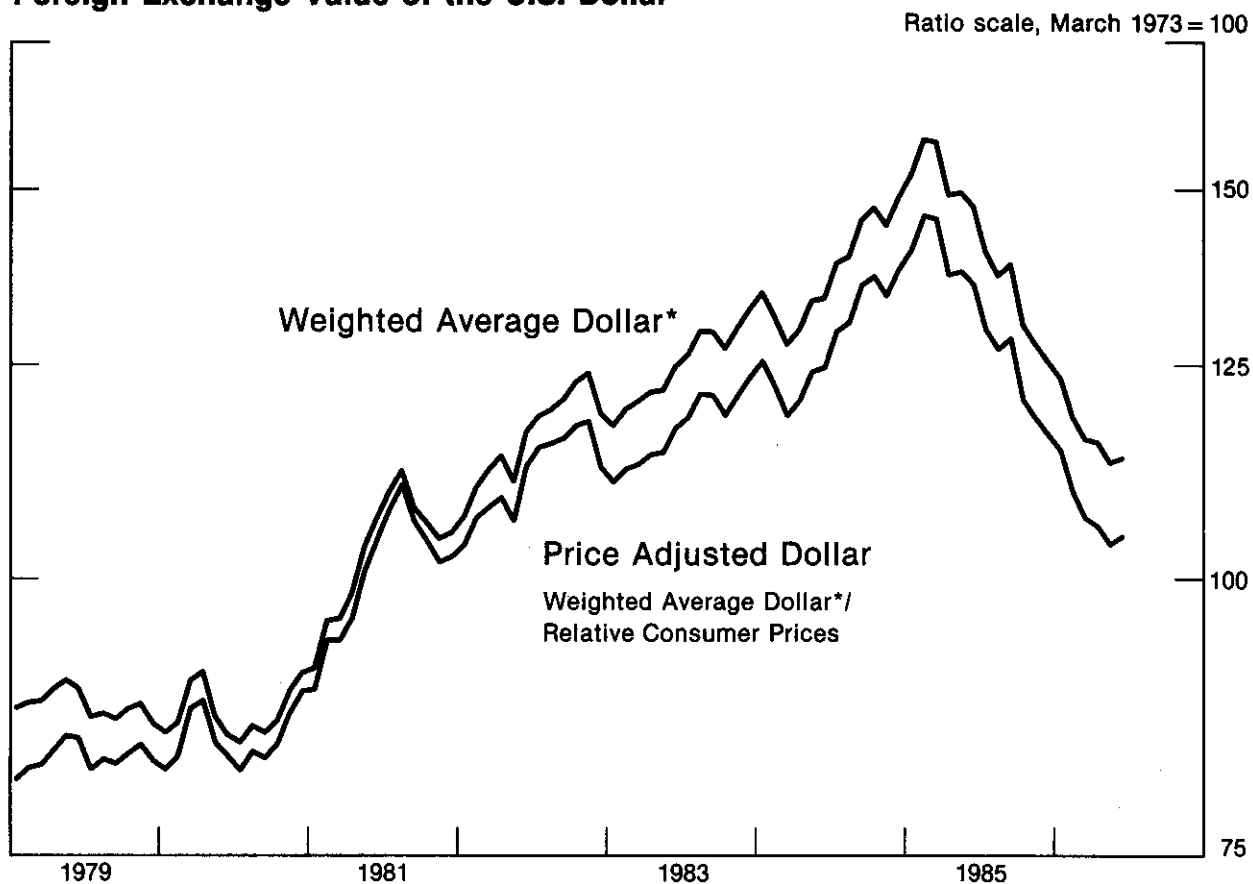
Labor Productivity and Unit Labor Costs



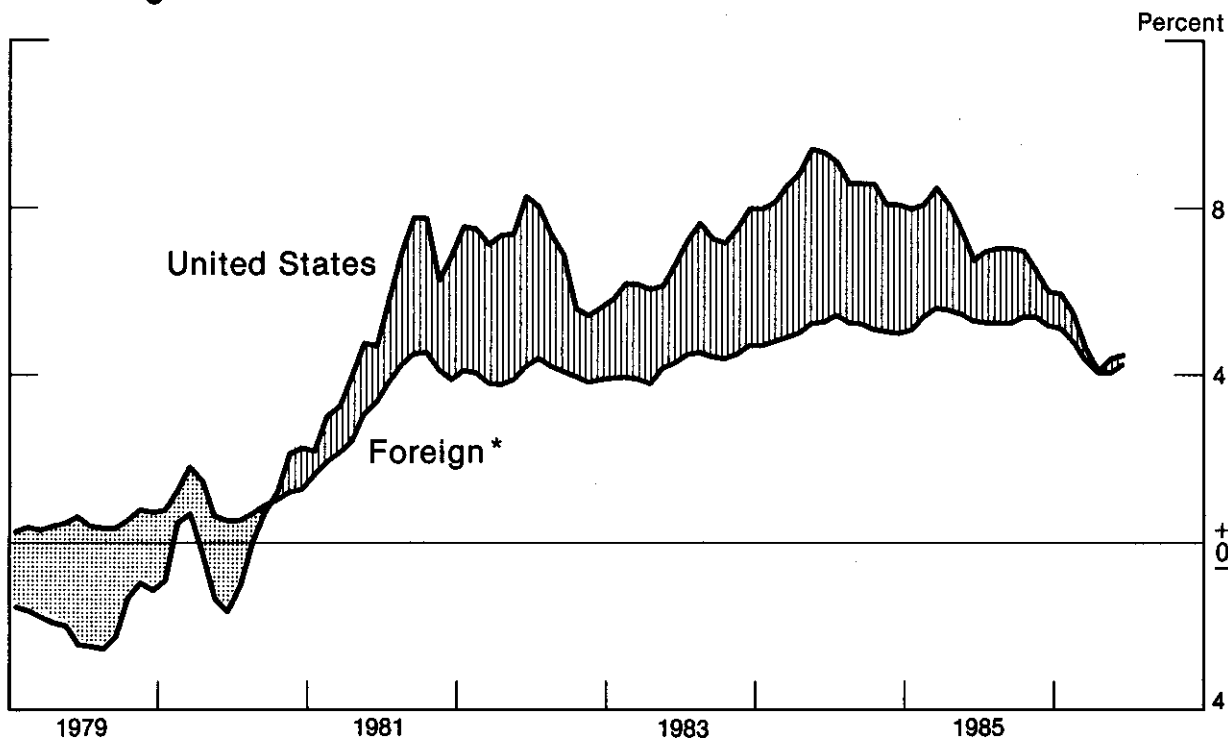
PCE Energy Prices**Non-Petroleum Import Prices****GNP Fixed-Weight Price Index**

GNP Fixed-Weight Price Index	
Change, Q4 to Q4 percent	
1985	3.5
1986	2.4
1987	3.4

Foreign Exchange Value of the U.S. Dollar



Real Long-term Interest Rates**

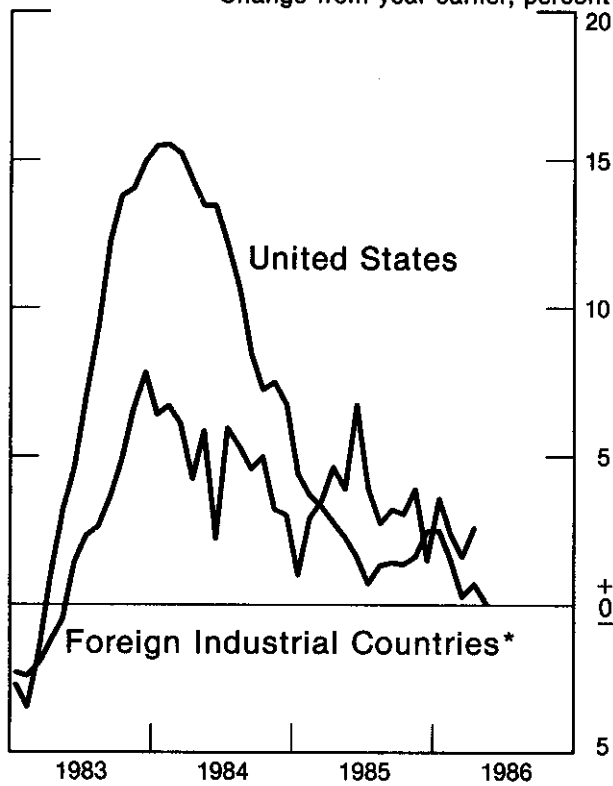


*Weighted average against or of foreign G-10 countries using total 1972-76 average trade.

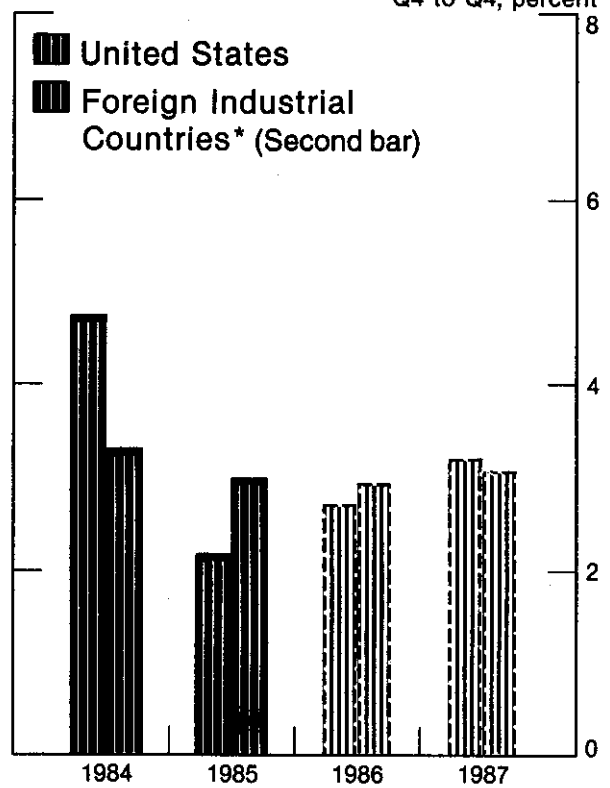
** Long-term government or public authority bond rates adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation (staff forecasts where needed).

Industrial Production

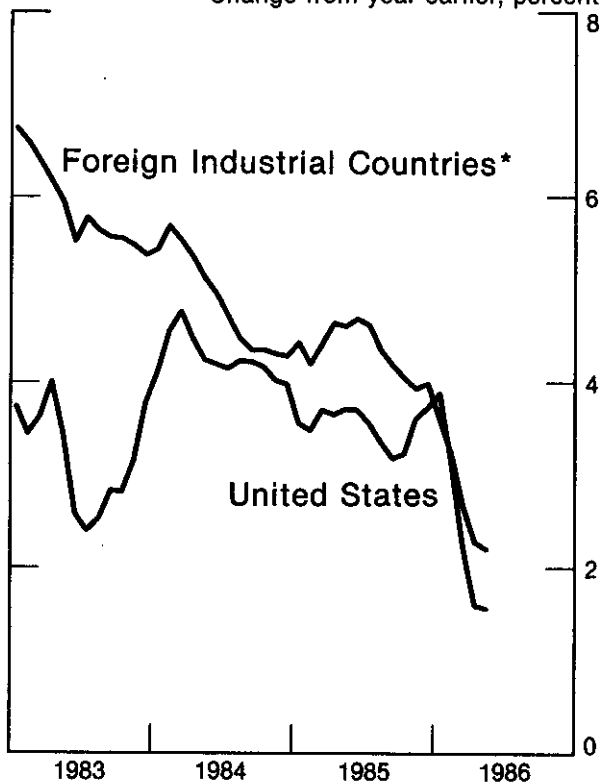
Change from year earlier, percent

**Real GNP**

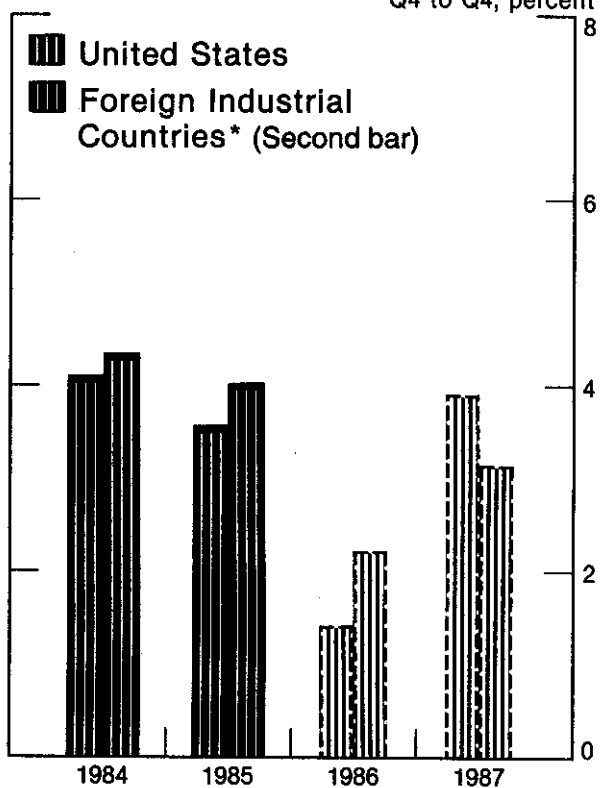
Q4 to Q4, percent

**Consumer Prices**

Change from year earlier, percent

**Consumer Prices**

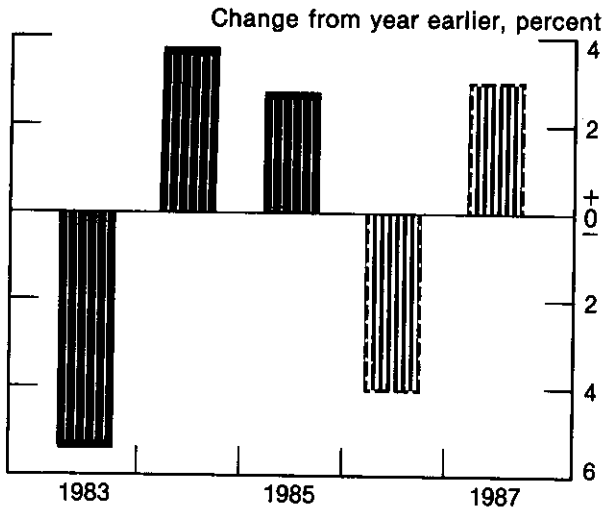
Q4 to Q4, percent



*Weighted average of the six major foreign industrial countries — Canada, France, Germany, Italy, Japan, United Kingdom — using total 1972-76 average trade.

Mexico

Real GDP



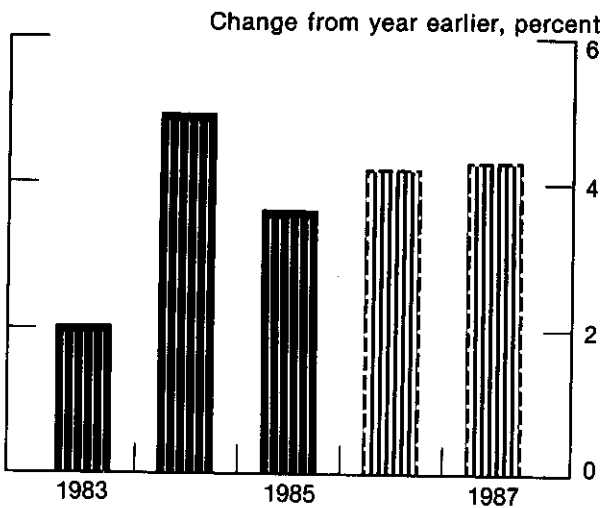
Current Account

Billions of dollars

1982	- 7.0
1983	5.2
1984	4.2
1985	0.5
1986	- 2.1
1987	- 1.8

Other Non-OPEC Developing Countries

Real GDP



Current Account

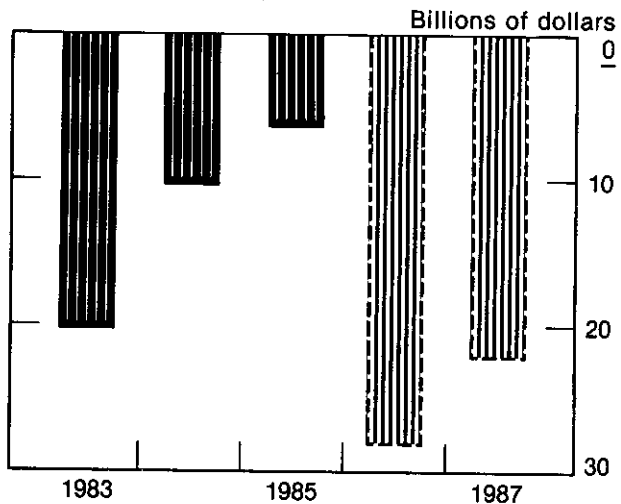
Billions of dollars

1982	- 61
1983	- 42
1984	- 27
1985	- 28
1986	- 25
1987	- 23

OPEC—Real GDP

Change from year earlier, percent	
1983	- 0.8
1984	1.6
1985	0.4
1986	2.5
1987	- 3.0

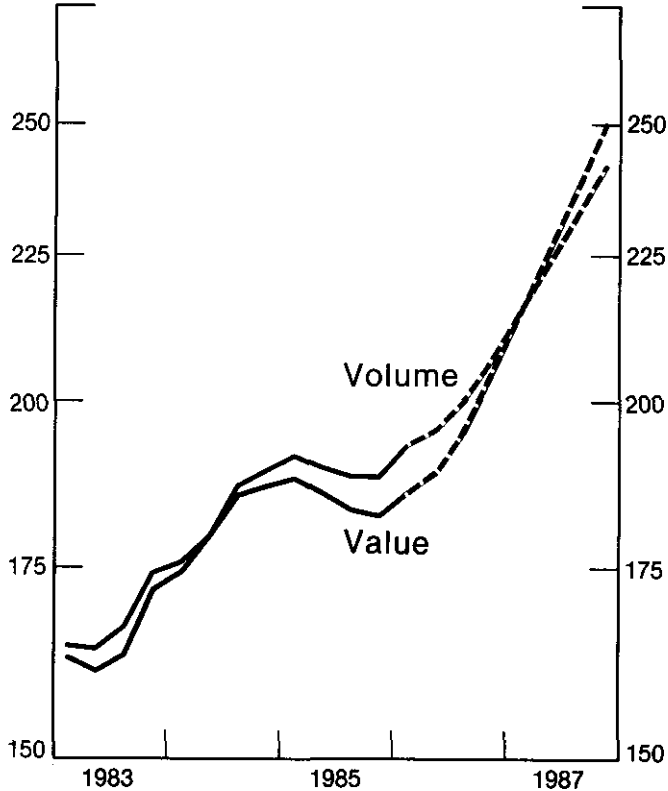
Current Account



Nonagricultural Exports

Ratio scale,
billions of 1982 dollars

Ratio scale,
billions of dollars



Destination of 1985 U.S. Nonagricultural Exports

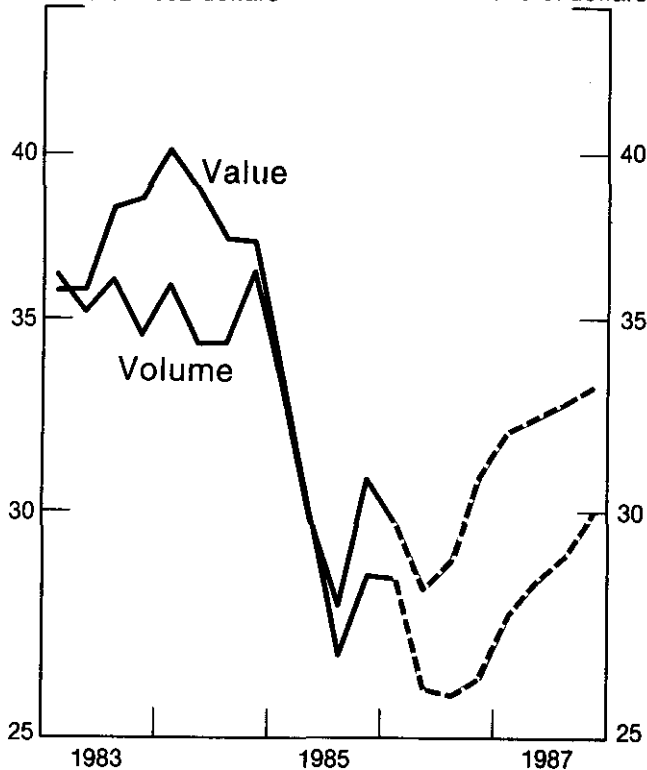
Percent

Japan	9
Canada	28
Other Industrial Countries	30
Mexico	3
Other Non-OPEC Developing Countries	6
OPEC	19
Communist Countries	5

Agricultural Exports

Ratio scale,
billions of 1982 dollars

Ratio scale,
billions of dollars



Destination of 1985 U.S. Agricultural Exports

Percent

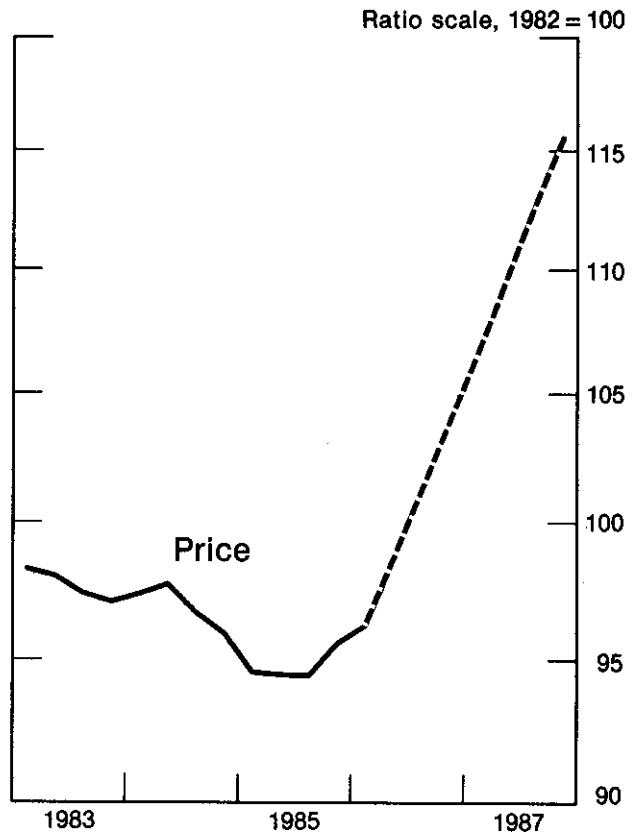
Japan	18
Canada	7
Other Industrial Countries	25
Mexico	8
Other Non-OPEC Developing Countries	5
OPEC	30
Communist Countries	7

Non-oil Imports

Changes in Price of U.S. Non-oil Imports

Percent, seasonally adjusted annual rates

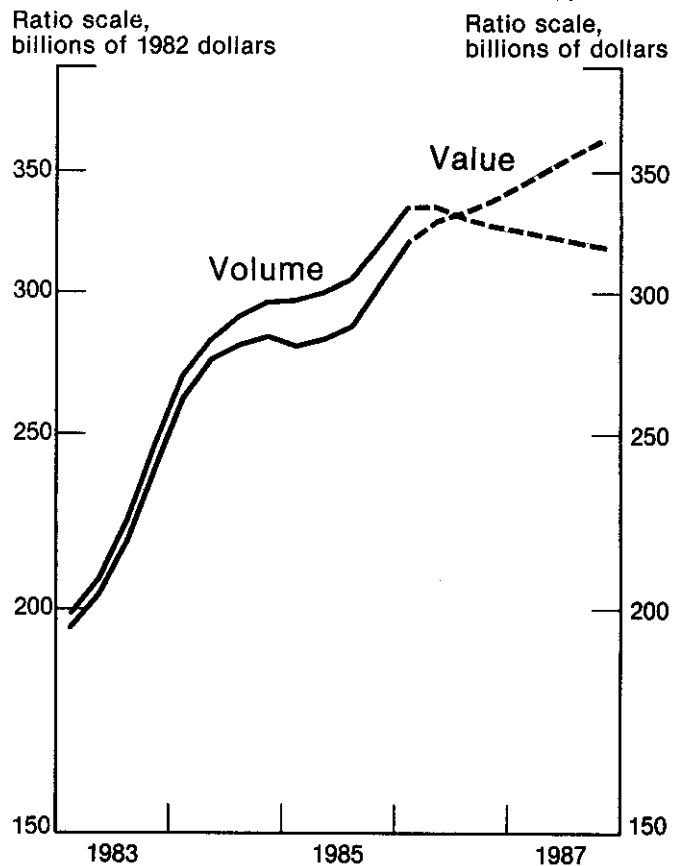
	<u>1985Q3</u> 1984Q3	<u>1986Q1</u> 1985Q3
Foods, Feeds, Beverages	- 7	15
Industrial Supplies	- 10	3
Capital Goods	- 3	6
Automotive Products	2	15
Consumer Goods	0	6
Total	- 3	6



Origin of 1985 U.S. Non-oil Imports

Percent

Japan	23
Canada	22
Other Industrial Countries	27
Communist Countries	1
Mexico	4
Other Developing Countries	23



Summary of U.S. Current Account Transactions

Billions of Dollars, Seasonally Adjusted Annual Rates

	1985	1986		1987	
		H1	H2	H1	H2
1. Exports	214	214	227	250	275
2. Nonagricultural	185	187	200	222	245
3. Agricultural	30	27	26	28	30
4. Imports	339	360	370	383	400
5. Non-Oil	288	325	336	348	363
6. Oil	51	35	34	35	37
7. Trade Balance	- 124	- 145	- 143	- 133	- 125
8. Other Current Account Transactions, Net	7	9	5	0	0
9. Current Account	- 118	- 136	- 138	- 133	- 125
10. Real GNP Net Exports of Goods and Services (1982 Dollars)	- 108	- 146	- 135	- 112	- 92

Forecast Summary

	Board Members		Presidents		Staff
Percent change, Q4 to Q4	Range	Median	Range	Median	
Nominal GNP					
1986	3¼ to 5½	4½	4¾ to 6½	5¾	5
1987	5 to 7	6	6 to 8¼	7½	6½
Real GNP					
1986	2¼ to 2¾	2¼	2½ to 3½	3	2¾
1987	2 to 4¼	3	2¾ to 4	3¼	3¼
GNP Deflator					
1986	1½ to 3	2¼	2 to 3¼	2½	2½
1987	1½ to 3¾	3	3 to 4¼	3¾	3
Average level, Q4, percent					
Unemployment Rate					
1986	7 to 7.2	7.0	6.9 to 7.1	7.0	6.9
1987	6¾ to 7.0	6.8	6½ to 7.0	6¾	6.6

FOMC Projections for 1985

Reported to Congress Feb. 19, 1986		
	Range	Central Tendency
Percent change, Q4 to Q4		
Nominal GNP	5 to 8½	6½ to 7¼
Real GNP	2¾ to 4¼	3 to 3½
GNP Deflator	2½ to 4¼	3 to 4
Average level, Q4, percent		
Unemployment Rate	6¼ to 6¾	About 6½